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COMMERCIAL REAL ESTATE PRICE DISCOVERY

Early last year I heard Mark Gibson with HFF use the term "Price Discovery". It seems it was a rather prophetic term that seems to be even more applicable as we move into 2017. I think back to an opportunity I pursued in June when I submitted a reasonable aggressive offer, but was outbid. At the time my debt quote was at 3.5%. The property fell out of escrow and came back in November. That same debt quote is at 4.5%. My offer price has to drop by at least 15%. The property is still available and may not trade at a price acceptable to the owner. There are so many factors having a "Push-Pull" on values, that price discovery is even more applicable now. On the plus side:

- Fundamentals are strong in all property types. In the industrial sector every metric is positive – occupancy, demand, rental growth.
- The development pipeline is in check and in most markets is only keeping pace with demand.
- The cost of debt has increased, but remains favorable, as the current run up still has the treasury approximately 200 basis points the historical average of the 10-year treasury.
- Real estate has an asset class has garnered world-wide acceptance, which is leading to continued investor demand.

However, there are macro level events that are causing ripples in this overall positive outlook. The re-set of US trade relations across the globe could lead to some short-term disruption while agreements get finalized. Brexit is leading to an evaluation by other EU nations that could have a further effect on trade and far reaching financial impacts should there be bond defaults. There will be change in domestic policy as Washington transitions to the new Administration, and capital markets take time to respond to change. While a general easing of regulations should lead to stronger economic growth, it is apparent that the Fed will allow rates to continue to increase toward more normalized levels.

So, what does all of this mean as you underwrite and value potential acquisitions? Here are some of my observations.

1. Stay disciplined to your business plan and go deeper in your target markets to know what drivers may be changing.
2. Keep an eye out for interior improvements that have enduring value as this will help reduce turnover costs on future leases.
3. Look for a quality rent roll with tenants who have an investment either in the space or the submarket. When the cycle changes, these tenants can give you a better chance to maintain high occupancy.
4. Plan on being flexible with your exit just in case there is a downturn and you need to hold longer to get through it